

Appl
Transurban
City Link v
FCT (2004) 54
ATR 750

[HIGH COURT OF AUSTRALIA.]

THE COMMISSIONER OF TAXATION
(WESTERN AUSTRALIA) . . . }
RESPONDENT,

APPELLANT ;

AND

BOULDER PERSEVERANCE LIMITED . . .
APPELLANT,

RESPONDENT.

ON APPEAL FROM THE SUPREME COURT OF
WESTERN AUSTRALIA.

Dividend Duty (W.A.)—Assessment—Deductions—Mining company—Profit-sharing notes—Profits payable to note holders—Dividend Duties Act 1902-1924 (W.A.) (No. 32 of 1902—No. 35 of 1924), secs. 6, 7.

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PERTH,
Sept. 30 ;
Oct. 5.

The *Dividend Duties Act* 1902-1924 (W.A.) is not confined to the taxation of the profits of a company that are available to shareholders and to no one else : its purpose is to tax the ultimate net profit made by the company without regard to its application or destination. The Act is not concerned with the mode in which the fund of final net profit is applied or divided under contractual or other arrangements made by a company with shareholders or others venturing capital in the business in the expectation of deriving profits according to the success of the company's operations. A division of this ultimate fund under such agreements or arrangements differs from the payment to a manager or other officer of a remuneration calculated upon profits or earnings : the performance of services so remunerated forms a necessary part of the operations which bring the net fund of profit into existence, and payment for those services is a prior charge upon the earnings of the business before the ascertainment of the fund of net profit available for division under the contractual arrangements between those supplying capital on terms of sharing the fund.

To carry on its business and to provide working capital a company raised a sum of £50,000 by means of profit-sharing notes. The notes bore interest

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principal sum of £50 shall be calculated from the 1933
to the 1st day of July 1933 and on the sum of £10 the balance of
the said principal sum shall be calculated from the 1933
to the 1st day of July 1933. 2. So long as any of the said notes are
outstanding the company covenants to divide amongst and pay to
the registered holders of such notes pro rata in proportion to the
amount of the notes held by them respectively within three calendar
months after the date of the certificate hereinafter mentioned 50
per cent of the profits of the company in each year commencing on
the 1st day of January 1932 as regards the £18,950 notes part of
the said £50,000 notes issued in the year 1931 and commencing on
the 1st day of January 1933 as regards the balance (including this
note) of the said £50,000 notes for the time being issued and out-
standing. The said profits shall be the profits as ascertained and
certified in writing by the auditors of the company for the time
being (whose decision as to the amount of such profits or that there
are none shall be final) after making provision for depreciation and
reserves and interest on the notes and any premium paid in respect
of notes redeemed in accordance with the conditions indorsed hereon
and for annual and other payments necessary in respect of any loans
made or guaranteed by or assistance given by any Government to
the company and for taxation. 3. The company hereby charges
with the payment of the said principal premium and interest and
with the payment of all sums (if any) which may become payable
under clause 2 hereof the whole of its property and assets for the
time being whatsoever and wheresoever including its uncalled capital.
4. This note is issued subject to and with the benefit of the con-
ditions indorsed hereon which shall be deemed to be incorporated
with and to form part of this note."

The company claimed that, in the calculation of its profits for
the purposes of the *Dividend Duties Act* 1902-1924 (W.A.), it was
entitled to deduct the amount returned to the shareholders, but the
Commissioner of Taxation disallowed the deduction. From this
decision the company appealed to the Supreme Court of Western
Australia, and the appeal was allowed by *Dwyer J.*

From this decision the commissioner appealed to the High Court.
Further facts appear in the judgment hereunder.

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Jackson K.C. and *Negus*, for the appellant. The question involved turns on the interpretation of the words "all profits made" in the *Dividend Duties Act* 1902. The *Companies Duty Act* 1899 (sec. 4) taxed the dividends of companies carrying on business in Western Australia only. Mining companies and companies carrying on business in Western Australia and elsewhere were taxed on "the amount of profit made" (sec. 5). The corresponding sections in the *Dividend Duties Act* 1902 are sec. 6 (as to dividends of companies carrying on business in Western Australia only) and sec. 7 (which taxes all profits of companies carrying on business in Western Australia and elsewhere). Sec. 6 was repealed by the *Dividend Duties Act Amendment Act* 1914, and the words "and elsewhere" were discarded from sec. 7. All companies are now taxed on profits, and dividends are no longer material. "Profits" is used in its ordinary commercial sense, i.e., profits arising from the trading or business operations of the company (*W. Thomas & Co. Ltd. v. Commissioner of Taxation (W.A.)* (1)). An expenditure which will not be incurred unless there is a profit is not an expenditure in order to earn a profit (*Last v. London Assurance Corporation* (2); *The Crown v. D. & W. Murray Ltd.* (3)). Remuneration to managers and directors out of profits may be regarded as an exception to this rule (*Indian Radio and Cable Communications Co. Ltd. v. Income Tax Commissioner* (4)). In *Pondicherry Railway Co. Ltd. v. Commissioner of Income Tax, Madras* (5) the court states that a payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits (See also *British Sugar Manufacturers Ltd. v. Harris* (6)); this case comes within the principle of the *Pondicherry Case* (5) or within the principle of joint adventure in the *Indian Radio Case* (4). *A. W. Walker & Co. v. Inland Revenue Commissioners* (7) is directly in point. [Counsel also referred to *Patent Castings Syndicate Ltd. v. Etherington* (8).] The commissioner is entitled to look at the contract. Here the note defined profit as what remained after allowing for taxation. If the respondent's contention is correct and profit is distributed before taxation, the note holders will receive more than they bargained for.

(1) (1931) 45 C.L.R. 539.

(2) (1885) 10 App. Cas. 438.

(3) (1909) 11 W.A.L.R. 92.

(4) (1937) 3 All E.R. 709, at p. 714.

(5) (1931) L.R. 58 Ind. App. 239.

(6) (1937) 3 All E.R. 702.

(7) (1920) 3 K.B. 648.

(8) (1919) 2 Ch. 254.

H. P. Downing K.C. and *E. F. Downing*, for the respondent. All items of outgoings which can be placed against profits must be taken into account, and not until that has been done can the commissioner assess profits. The profit aimed at by the Act is the profit available for dividend (*W. Thomas & Co. Ltd. v. Commissioner of Taxation* (W.A.) (1)). Profit is that which is left after taking away all payments which have to be made out of the money earned by the company (See *Forwood Down & Co. Ltd. v. Commissioner of Taxation* (W.A.) (2)). The expenditure under a genuine contract in respect of borrowed money must be deducted. [Counsel referred to the *Land and Income Tax Assesment Act* 1907-1931 (W.A.) secs. 15 (1) (c), 18 (3).]

[DIXON J. referred to *Pegg & Ellam Jones Ltd. v. Inland Revenue Commissioners* (3).]

The interest is part of the profit (*Wilson v. Mannooch* (4); *Gresham Life Assurance Society v. Styles* (5); *Indian Radio and Cable Communications Co. Ltd. v. Income Tax Commissioner* (6)). The profit taxed under the Act is the true net profit (*British Sugar Manufacturers Ltd. v. Harris* (7); *Davies Coop & Co. Pty. Ltd. v. The Commonwealth* (8)). This case does not differ in principle from one in which remuneration for services is made by a percentage of the profits (*Tilt v. Tilt's Cafes Ltd.* (9)). There can be no difference between the remuneration paid to a person who lends money to carry on a business and the remuneration of an employee depending on a profit. Both are payable under an agreement to enable the profit to be earned. Therefore the company is entitled to the deduction.

Negus, in reply.

Cur. adv. vult.

THE COURT delivered the following written judgment :—

The *Dividend Duties Act* 1902-1924 of Western Australia requires every company carrying on business in Western Australia to pay a duty or tax upon the profits made by such company in Western Australia.

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| (1) (1930) 33 W.A.L.R. 45; 45 C.L.R. 539 | (5) (1892) A.C. 309, at pp. 314, 325. |
| (2) (1935) 53 C.L.R. 403. | (6) (1937) 3 All E.R. 709. |
| (3) (1919) 12 Tax Cas. 82, at p. 90. | (7) (1937) 3 All E.R. 702. |
| (4) (1937) 3 All E.R. 120. | (8) (1935) 54 C.L.R. 155. |
| | (9) (1930) V.L.R. 31. |

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The respondent company carries on the business of gold mining in that State. It is incorporated in England, and in 1931 it raised capital in London upon what in its balance-sheet are called "ten-year 10% profit-sharing notes." These were in fact an issue of debentures repayable in ten years' time. Each note or debenture expressed an obligation to repay to the holder the amount it specified, together with a premium, and to pay interest thereon in the meantime at the rate of ten per cent per annum. It contained also a covenant by the company to divide amongst and pay to the registered holders of the notes pro rata in proportion to the amount of the notes held by them respectively fifty per cent of the profits of the company in each year. The covenant referred the ascertainment of the profits to the auditors of the company but directed that the profits should be ascertained after making provision for various outgoings, including taxation. In the calendar year 1933 the company made profits in respect of which payments representing fifty per cent were made in London in the following year, in which also it made profits. In returning the profits of the latter year, viz., 1934, for the purpose of dividend duty, the company sought to deduct the payment of fifty per cent of the preceding year's profits so made to the note holders or debenture holders. The Commissioner of Taxation disallowed the deduction, but, on appeal to the Supreme Court, *Dwyer J.* varied the assessment by excluding therefrom fifty per cent of the profits payable to the holders of the ten-year profit-sharing notes. The commissioner appeals against this order.

In substance the question thus raised is whether, on the one hand, the taxable fund of profits is ascertained after the prior deduction of the payments received by the debenture or note holders, or, on the other hand, the debenture or note holders receive a share of the taxable fund of profits.

The respondent company contends that the payment described as fifty per cent of the profits of the company is an expense necessarily incurred in order to obtain the capital secured by the debentures or notes and that, like interest, it is money laid out for the purpose of earning profits, that is, the final balance of profits which the company may consider as won or gained on its own account. In the assessment the amount paid as interest calculated at ten per

cent per annum upon the capital thus secured by the debentures or notes has been allowed as a proper deduction in arriving at taxable profits, and the company says that the payment of fifty per cent of its profits to the holders is indistinguishable from the payment of interest.

On the other hand, the respondent, the commissioner, contends that the provision contained in the instruments conferring on the holders a right to share in the profits is no more than a contract for the division of the profits made by the company and that the mode in which profits are applied or disposed of is quite irrelevant to their liability to taxation. He says that, except that the capital secured by the debentures or notes is to be returned or repaid at a specified time, it resembles share capital in the nature of the right which it carries to participate in profits.

There is nothing new in the problem of distinguishing between a distribution of the profits or income forming the subject or part of the subject of an income tax or profits tax and a payment which, although made to earn those profits and therefore a necessary deduction in ascertaining them, is nevertheless calculated as a percentage of the profits otherwise available.

Many contracts of service provide for a remuneration varying with the profits derived from the business to which the service is given. If expenditure is in truth no more than remuneration for work done for the purpose of producing income or profits, it must be deducted from the earnings before the net income or profits can be found. This is no less necessary when the amount of remuneration is dependent upon the amount of the earnings of the business diminished by the deduction therefrom of all other expenses incurred in the production of the income or profit. At the same time it is apparent that, when work performed in the course of a business is remunerated by a share or percentage of the profits, the position of the person remunerated may be brought so close to that of a partner sharing in a distribution of the final balance of profits earned as to be practically indistinguishable. In the same way, when money is borrowed for use in the business, the reward of the lender in the form of interest is regarded as a necessary or proper deduction for the purpose of ascertaining the profits of the business, and the fact

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that the reward is made to vary with the success of the business ought not to affect its character as an expenditure incurred for the purpose of earning profit. Yet capital may be invested in a business in order to obtain a share in the profits indistinguishable from that of the proprietor. The solution of the difficulty must in every case be found in determining the point as at which the ascertainment of net profits is required, and this depends upon the purpose for which they are to be computed. Profits may be regarded as a fund composed of receipts which must be applied to various purposes in succession. In this view it is a fund subject to diminution by an indefinite succession of disbursements or outgoings until it is finally dissipated. In its course from the initial receipt to its final distribution, the fund may be computed at different points for different purposes. If the purpose is to find what the business returns to its proprietors in a form which they can enjoy as they choose, a point must be taken at which every other expenditure to which the fund must be applied has already been deducted. But, to illustrate the difference which the nature of the purpose makes in the point at which profits are computed, an imaginary example of an opposite extreme may be taken. Suppose the purpose were to find what amount was to be provided by a business for the remuneration of labour in order to fulfil an obligation to reward all those who contributed their labour to an enterprise by dividing profits among them. In such a supposed case no deduction would be allowable on account even of wages, still less of remuneration calculated as a percentage upon the earnings of the business.

The *Dividend Duties Act* 1902-1924 (W.A.) does not, as most modern *Income Tax Acts* do, specify or define the classes of deductions from gross profits that may be allowed. It simply taxes the profits made in Western Australia by a company carrying on business in Western Australia. The word "profits" is not defined, and their ascertainment is in a general way to be governed by those conceptions of business to which resort was made in the analogous case of *Lawless v. Sullivan* (1). The legislation has had a strange history, and the statute retains many provisions, as well as a short title, which suggest that its purpose was to tax dividends payable to shareholders. If

(1) (1881) 6 App. Cas. 373.

it were now true that it means only to tax profit available for dividend, to levy a contribution to the Crown from the "dividend fund" of companies, the final fund "belonging" to the shareholders, much might be said in support of the view that the point at which the net profits made by the company are to be determined is a point reached only after every application of the fund has been made which has priority to the distribution of the fund to shareholders or its appropriation to attend their demands or directions. If so, the "profits" payable to the note or debenture holders would be deductible before the taxable profits were ascertained. But we do not think that the legislation has this restricted meaning or, indeed, ever had. A distinction was once drawn between companies taxable upon profits earned in Western Australia and companies taxable on dividends distributed. But this distinction has disappeared from the Act and now, in spite of the failure to repeal provisions which the new plan of the legislation rendered obsolete and superfluous, the purpose of the Act is to tax simply the profits earned in Western Australia by companies there carrying on business. There is no description of company which the *Dividend Duties Act* now taxes in respect of dividends or of profits available for distribution among shareholders as distinguished from "profits" generally. In other words, the availability of profits for distribution is not taken as a test of liability. In *W. Thomas & Co. Ltd. v. Commissioner of Taxation W.A.* (1) this court declined to treat availability for dividend as the test of the kind of profits taxed, for the purpose of deciding whether profits from an increase in the value of capital assets were taxable, and restricted the application of the tax now levied by the *Dividend Duties Act* to trading profits, that is, profits from the conduct of the company's business.

The purpose of the Act is to tax in the hands of companies all profits they make in the State without regard to the manner in which the profits are dealt with. In this view it becomes, we think, immaterial whether the profits are earned by the employment of share capital or debenture capital. It is not denied that the fixed interest charges on debenture capital constitute a prior deduction in the calculation of the "profits made by the company." Such

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charges are regarded as an ordinary business expenditure. But, when the debenture contract lets the debenture holder into participation in the "trading profits" over and above his fixed interest charge, it gives his debenture capital an additional characteristic, a characteristic inconsistent with that of a simple external loan by a creditor looking only for security for his capital and a certain regular remuneration for its use. The point at which the *Dividend Duties Act*, in order that its purpose may be answered, requires that "profits made" shall be ascertained is after deducting all the expenses, including interest on borrowed money, incurred in the course of conducting the business of the company and before the fund of profit is applied to the use of those who have obtained a title to its enjoyment by subscribing share capital or by purchase or otherwise by contract. It may be that the possibility of sharing in profit formed an inducement to the note or debenture holders, but it is the interest at ten per cent per annum that alone represents the actual compensation for the use in the business of the capital so raised for which a deduction should be made in finding the business profits. The share in the profits appears to us to represent a right to the distribution of the fund finally earned by the business, the taxable fund.

The case closely resembles *A. W. Walker & Co. v. Inland Revenue Commissioners* (1), decided by *Rowlatt J.* There the taxpayers borrowed £4,000 for the use of their business on terms of paying the lender £200 per annum and three-twentieths of their net profits. The question was whether, in assessing the net profit of the business for excess profits duty, the payments to the lenders representing three-twentieths of the net profits were deductible under a provision which allowed the deduction of interest on money borrowed for the purpose of the trade or for other payments income tax on which is collected at the source (not being payments of dividends or payments for the distribution of profits). It was conceded that the £200 was deductible as interest, and *Rowlatt J.* said that both that sum and the share of the profits were alike the consideration for the loan. "That" he said "is why they are paid, but the two sums stand on entirely different footings. The persons who lent

this money receive interest on the money lent which is payable to them as a debt, and for that purpose it is immaterial whether the business prospers or languishes"—“they also receive a share of what the business earns. That is not interest; it is simply a share of the profits” (1). His Lordship agreed that it appeared from the provisions of the statute that a salary or remuneration was allowable in calculating excess profits duty, although the amount depended upon the profits of the trade or business. But the case did not come under that head. “The contract simply gives the lenders a share of the profits, without any rights or liabilities of partners; it simply takes three-twentieths of the profits and gives it to the lenders and the borrowers take the other seventeen-twentieths themselves.”

Examples of payments out of taxable profits as distinguished from payments prior to the ascertainment of such profits will be found in *Mersey Docks and Harbour Board v. Lucas* (2); *Last v. London Assurance Corporation* (3); *Madras and Southern Mahratta Railway Co. Ltd. v. Inland Revenue Commissioners* (4); *Inland Revenue Commissioners v. City of Buenos Ayres Tramways Co. (1904) Ltd.* (5); *Inland Revenue Commissioners v. Mashonaland Railway Co. Ltd.* (6); *Pondicherry Railway Co. Ltd. v. Commissioner of Income Tax, Madras* (7), per Lord Macmillan, as to which see *Adamson v. Union Cold Storage Co. Ltd.* (8), *Tata Hydro-Electric Agencies Ltd. v. Income Tax Commissioner* (9) and *Indian Radio and Cable Communications Co. Ltd. v. Income Tax Commissioner* (10). The last case affords another illustration of a payment held to be a distribution of the taxable fund and not to be an antecedent deduction, and still another illustration is supplied by *British Sugar Manufacturers Ltd. v. Harris* (11).

All these cases depend upon the scope, purpose and interpretation of the particular statutory provisions requiring the ascertainment of profits under which they were decided and upon the nature of the

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| (1) (1920) 3 K.B., at p. 653. | (6) (1926) 12 Tax Cas. 1159, at pp. 1167, 1168. |
| (2) (1883) 8 App. Cas. 891; 2 Tax Cas. 25. | (7) (1931) L.R. 58 Ind. App. at pp. 251, 252. |
| (3) (1885) 10 App. Cas. 438; 2 Tax Cas. 100. | (8) (1931) 146 L.T. 172, at p. 179. |
| (4) (1926) 12 Tax Cas. 1111, at pp. 1123, 1124. | (9) (1937) 2 All E.R. 291, at p. 295. |
| (5) (1926) 12 Tax Cas. 1125, at pp. 1143-1145. | (10) (1937) 3 All E.R. at pp. 713-715. |
| | (11) (1937) 3 All E.R. 702. |

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contract the parties chose to make in the given case or of the obligations to make the payment howsoever arising. But they contain discussions of the distinction upon which this case turns and of the considerations affecting the application of that distinction.

The nature of the contract in the present case appears to be clear enough. The parties adopted a contract for the division between them of the ultimate net profit made by the company. It is more than a payment contingent upon the making of net profits and proportional to their amount. It is a payment of part of the net profits under that description. No doubt Lord *Macmillan* made too absolute a statement in *Pondicherry Railway Co. Ltd. v. Commissioner of Income Tax, Madras* (1) when he said that "a payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits." In *Indian Radio and Cable Communications Co. Ltd. v. Income Tax Commissioner* (2) Lord *Maugham* said that it might be admitted that it is not universally true to say that a payment the making of which is conditional on profits being made cannot properly be described as an expenditure incurred for the purpose of earning such profits. What is important, however, is the fact that the fund which under the contract the company divides with the debenture or note holders is the fund of profit cleared of all other charges whatsoever, with the contingent exception of the tax or taxes thereon.

Now, in our opinion, the statutory provisions seek to tax this very fund which they have so agreed to divide. It is the purpose of the statute to tax the ultimate net profit earned in Western Australia by a company regarded as a profit-making concern. The assets of such a concern may be acquired out of moneys arising from various sources, share capital, accumulated profits or capital raised by the issue of debentures. If the capital is hazarded in the enterprise in the hope or expectation of a share of the profits, its character as share capital or debenture capital is nothing to the purpose of the statute, which is to tax the ultimate net profit made by the company without regard to its application or destination. We do not think the purpose of the *Dividend Duties Act* is confined to the taxation of profits that are available to shareholders and to no one

(1) (1931) L.R. 58 Ind. App., at p. 251.

(2) (1937) 3 All E.R., at p. 713.

else. The Act is not concerned with the mode in which the fund of final net profit is applied or divided under contractual or other arrangements made by a company with shareholders or others venturing capital in the business in the expectation of deriving profits according to the success of the company's operations. A division of this ultimate fund under such agreements or arrangements differs widely from the payment of a manager or other officer a remuneration calculated upon profits or earnings. The performance of services so remunerated forms a necessary part of the operations which bring the net fund of profit into existence, and payment for these services must be rewarded as a prior charge upon the earnings of the business before the ascertainment of the fund of net profit available for division under the contractual arrangements between those supplying capital on terms of sharing the fund.

For these reasons we are of opinion that the deduction was rightly disallowed by the Commissioner of Taxation. We are unable to agree in the decision of *Dwyer J.*, which, in our opinion, should be reversed.

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Appeal allowed with costs. Judgment of Supreme Court set aside. Assessment affirmed. Respondent to pay appellant's costs of proceedings in Supreme Court.

Solicitor for the appellant, *A. A. Wolff*, K.C., Crown Solicitor for Western Australia.

Solicitors for the respondent, *Downing & Downing*.